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No. 94-1796

Supreme Court, U.S.
FILED
JUL 14 1995
CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

ALBERTSON'S, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF OF AMICI CURIAE, CONNECTICUT MUTUAL LIFE INSURANCE COMPANY, NEW ENGLAND MUTUAL LIFE INSURANCE COMPANY, STANDARD INSURANCE COMPANY AND STATE MUTUAL LIFE ASSURANCE COMPANY OF AMERICA IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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INTEREST OF AMICI CURIAE

Pursuant to Rule 37.2 of the Rules of the Supreme Court of the United States, *amici curiae*, Connecticut Mutual Life Insurance Company, New England Mutual Life Insurance Company, Northwestern Mutual Life Insurance Company, Standard Insurance Company, and State Mutual Life

Assurance Company of America file this joint brief in support of the petition for writ of certiorari filed by Albertson's, Inc. on the first question presented, relating to the federal income tax treatment of interest on deferred compensation.[1]

Petitioner's case involves the deductibility of interest credited under elective, nonqualified deferred compensation arrangements that covered certain of Petitioner's key executives and one of its directors. In considering the petition for writ of certiorari, this Court should be aware that American businesses, including *amici*, commonly make use of elective, nonqualified deferred compensation arrangements. This Court should also be aware that many elective deferred compensation arrangements are not limited solely to a company's executives and directors. Many arrangements, including those of *amici* as discussed below, cover independent contractors who are not part of the management of the businesses for which they provide services.

Amici are life insurance companies engaged in the business of selling life insurance, annuity, and other insurance contracts. As is typical in the life insurance industry, *amici* rely on the services of a large network of geographically dispersed insurance agents who are independent contractors. The contracts *amici* enter into with their insurance agents prescribe the total compensation to be paid such agents for insurance product sales and related

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[1] Petitioner and Respondent, through their counsel, have consented to the filing of this brief in letters filed with the Clerk of this Court. *Amici* express no views on the second question presented, arising under section 48 of the Internal Revenue Code ("Code"). Unless otherwise indicated, section references herein are to the Code, 26 U.S.C., as in effect for Petitioner's tax year in question (ending February 3, 1983).

services rendered. Under these contracts, the agents are compensated for their services on the basis of a fixed percentage of first-year and renewal premiums received in respect of insurance policies sold by such agents.

As is also common in the life insurance industry, *amici* have for many years maintained elective deferred compensation arrangements similar to those at issue here with agents who wish to participate in such arrangements. In fact, basic tax law relating to nonqualified deferred compensation was established in *Commissioner v. Oates*, 207 F.2d 711 (7th Cir. 1953), *aff'g* 18 T.C. 570 (1952), by a life insurance agent who decided to defer receiving commissions pursuant to an elective arrangement under which such commissions, plus interest, were credited over a period of years to a bookkeeping account maintained in his name.

The elective deferred compensation arrangements maintained by *amici* simply allow insurance agents to defer until a future date the receipt of compensation they earn upon performing services. The amount of compensation deferred and the period of deferral are selected by the agent. Prior to the payment date, the deferred amount is retained by *amici* and is available for corporate use. *Amici* keep track of the deferred amounts through bookkeeping accounts maintained for each agent. The deferred compensation arrangement is no more than an unfunded, unsecured promise — *i.e.*, a debt owed — by *amici* to pay an agent's compensation in the future.

In return for having the use of the deferred compensation for which *amici* are indebted, *amici* credit interest to the bookkeeping accounts maintained in the names of the agents for the period during which such compensation is deferred. Interest is first credited to such an account only after a

specified period of time has elapsed (*e.g.*, a month) since the deferred compensation was earned and credited to such account. Interest is also credited thereafter with the passage of time (*e.g.*, on a monthly basis). In short, interest credited under elective deferred compensation arrangements is a function of the passage of time, the amount in the account, and the applicable interest rate. It is not a function of services performed.

Therefore, as is also true in Petitioner's case, the compensation for services rendered by the agents of *amici* and the interest credited under their deferred compensation agreements are separate and distinct items. There is no relationship between the total compensation payable for services rendered by the agents and the interest credited under the deferred compensation agreements. The interest reflects the time value of the use by *amici*, and the forbearance of use by the agents, of the compensation deferred by the agents. There is no reason for the amount of compensation for services rendered by the agents to increase as a result of the deferral of the payment for such services. The services are not worth more simply because the payment for them is delayed.[2] There is, however, a sound reason for adding interest to the deferred amounts: as a result of services performed by their agents, *amici* are indebted to them for the compensation that is deferred and have the use of the compensation so deferred during the deferral period.

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[2] Indeed, it would be a violation of New York insurance law (which effectively sets nationwide limits on sales expenses for those life insurance companies doing business in New York) to compensate life insurance agents by paying them additional compensation that is disguised as interest. *See* N.Y. Ins. Law § 4228 (McKinney 1985).

Amici, like other companies taxed on the basis of accrual accounting both within and without the life insurance industry, have long been deducting when accrued the interest credited under their elective deferred compensation arrangements. Thus, Petitioner's treatment of the interest at issue is by no means unique. For many years, the Commissioner of Internal Revenue (the "Commissioner") raised no question with respect to the current deduction of accrued interest credited under elective deferred compensation arrangements. Indeed, prior to litigating the present case, the Commissioner never officially announced that it is her position that such interest is not currently deductible.[3] More recently, on audit of the tax returns of several *amici*, the Commissioner disallowed the claimed deduction of such accrued interest. One *amicus* now has a related issue in litigation.[4]

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[3] The Commissioner did issue several unofficial and nonprecedential pronouncements on the question, which did not contain authoritative support or meaningful analysis. *See, e.g.*, Priv. Ltr. Rul. 8619006 (Jan. 30, 1986), a technical advice memorandum which was issued to Petitioner in this case and which merely concluded that the amounts characterized as "interest" by Petitioner "appear to be more appropriately classified as additional compensation subject to section 404(a)(5) of the Code."

[4] *New England Mut. Life Ins. Co. v. United States*, No. 92-257T (Ct. Fed. Cl. filed Apr. 9, 1992). This case involves the tax characterization of "interest" accrued on deferred compensation obligations to independent contractors. Because the tax years involved in this case precede the date when the statutory provisions at issue in Petitioner's case were extended to arrangements involving independent contractors, the litigation involving *amicus* raises the question of whether the interest credited on deferred compensation obligations is "interest on indebtedness" for tax purposes. For later tax years, all the issues raised by Petitioner's case are also applicable to *amicus*.

In sum, the decision in this case with respect to interest on deferred compensation is of direct and substantial interest to *amici*, as well as other employers.

SUMMARY OF ARGUMENT

The Court of Appeals, *by its own admission*, disregarded the language of the Internal Revenue Code and took it upon itself to rewrite the statutory provisions in question on the basis of "policy" views that cannot demonstrably be attributed to Congress. The substantive tax issue raised has potentially broad applicability, and has significant import to taxpayers as well as to the federal fisc. Review of this issue by this Court is therefore warranted.

ARGUMENT

The issue in this case of interest to *amici* is whether the deduction of interest accrued on nonqualified deferred compensation obligations is governed by normal tax principles for interest deductions, as Petitioner argues, or by the timing rules of sections 404(a)(5) and 404(d) of the Code, as the Commissioner contends.

Section 404(a)(5) (governing deferred compensation arrangements with employees) and section 404(d) (governing such arrangements with independent contractors) set forth in specific and unambiguous terms the category of deductions to which the timing rules of those provisions apply. Those sections state in relevant part that "compensation," accrued under a plan deferring its receipt, is to be deductible for the taxable year in which it is includible in the gross income of the individuals participating in the plan. Those provisions make no reference to "interest." Further, for the tax years in question, those provisions expressly applied only to "compensation" that satisfied the conditions of section 162

(for deducting business expenses) or section 212 (for deducting an individual's expenses for the production of income). Those references reinforced that "interest," which is deductible under section 163 rather than section 162 or section 212, is beyond the scope of section 404.

In deciding the case below, the Court of Appeals agreed with Petitioner that section 404 by its terms did not apply to Petitioner's deduction for "interest":

> [U]nder a literal reading of the statutory language, the deduction of interest is not affected by section 404.

Pet. App. at 16a. Nonetheless, the court resolved this issue against Petitioner on the basis of tax policy considerations urged by the Commissioner, for which the court found a basis primarily in the views of certain commentators[5] rather than in the language or legislative history of the Internal Revenue Code. Pet. App. at 10a-17a. The Court of Appeals concluded:

> *[D]espite the literal wording of the statute*, Congress could not have intended to exclude interest payments, a substantial part of the deferred compensation package, from the rule prohibiting deductions until such time as the employee receives the benefits.

Pet. App. at 18a (emphasis added).

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[5] In the petition for writ of certiorari at 17, Petitioner has noted other commentators who supported the decision for Petitioner initially rendered below by the Court of Appeals.

There are special and important reasons for this Court's review of this decision on writ of certiorari. The Court of Appeals did not resort to "policy" concerns to interpret an ambiguous statute. The Court of Appeals did not subordinate the language of the Code to an articulated contrary expression of Congressional intent. Rather, in a singularly bald example of judicial legislation, the Court of Appeals explicitly disregarded the literal terms of the Code in favor of purported policy considerations that were not and cannot be demonstrably ascribed to Congress. Pet. App. at 10a-18a.

It is axiomatic that "[u]nder our constitutional framework, federal courts do not sit as councils of revision, empowered to rewrite legislation in accord with their own conceptions of prudent public policy." *United States v. Rutherford*, 442 U.S. 544, 555 (1979). Adherence to statutory language is particularly important in tax cases. The Internal Revenue Code is replete with formal rules and fine distinctions, reflecting refined tax theory in some instances and political compromise in other instances. The language of the Code cannot be contrary to tax policy; it *is* tax policy, and must be respected.

The effort of the Court of Appeals to ascertain for itself the proper "policy" conclusion misdirected that court's decision. The key policy conclusion on which that court relied is that a "matching principle" should apply to deductions for interest with respect to deferred compensation, in order to avoid an incentive for taxpayers to adopt these arrangements rather than tax-qualified retirement plans (*i.e.*, plans qualified under section 401(a) of the Code). Pet. App. at 11a-12a. Section 404 requires such "matching" with respect to deferred compensation for services. With respect to interest accrued on deferred compensation,

however, the tax "policy" of "matching" simply cannot be attributed to the Code or to Congress.

A "matching" principle is not inherent in the overall structure of the Code. To the contrary, under basic tax law principles, some taxpayers may determine their income tax on a cash basis of accounting, and other taxpayers may determine their income tax on an accrual basis. *See* Code section 446(c). Under this system, "mismatches" between an accrual-basis debtor's interest deduction and a cash-basis creditor's recognition of interest income necessarily will occur. In specific circumstances, Congress has affirmatively required "matching" with respect to interest. *See*, *e.g.*, sections 163(b), 267(a)(2), and 467 of the Code as currently in effect; *compare* sections 163(e)(1) and 1272(a)(1) of the Code as currently in effect. Section 404 states no such requirement.

Furthermore, a "matching" principle is not indispensable to Congressional efforts to encourage tax-qualified retirement plans. Qualified plans enjoy a number of important tax advantages unavailable to (nonqualified) deferred compensation arrangements. For example, contributions to qualified plans are immediately deductible, favorable tax rules may apply to qualified plan distributions (including beneficial income-averaging treatment and tax-free rollovers), and benefits provided by qualified plans are "funded" and protected from creditors.[6] Congress could rationally have concluded that those advantages sufficed to provide any intended incentive in favor of qualified plans, regardless of the deductibility of interest accruals under deferred compensation arrangements. The decision below is

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[6] *See* sections 401(a), 401(a)(2), 402(c), 402(d), 404(a)(1) of the Code as currently in effect.

wholly unsupported by any evidence of a legislative calculus rejecting the sufficiency of these other advantages.

In addition, in their capacity as providers of retirement arrangements, *amici* can attest that they and many other employers have not and would not abandon their qualified plans, as the Court of Appeals suggested, if interest accruals under deferred compensation arrangements are deductible. The foregoing advantages of, as well as the business purposes served by, qualified plans assure their continued use. Many taxpayers must provide retirement benefits to attract and retain employees and, because non-management employees generally cannot be covered by nonqualified deferred compensation arrangements,[7] these taxpayers effectively must maintain tax-qualified retirement plans. Conversely, some taxpayers may enter into deferred compensation arrangements with independent contractors, for whom such taxpayers may not permissibly maintain tax-qualified retirement plans because such plans may cover only common-law employees and certain statutory employees.[8] The policy considerations on which the appellate court relied are irrelevant to these taxpayers.

This case therefore is not like *Bob Jones University v. United States*, 461 U.S. 574 (1983), or *United States v. American Trucking Ass'ns*, 310 U.S. 534 (1940), on which the Court of Appeals relied. The language of section 404 is

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[7] Because of the interplay between the Code and the labor law title of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), 29 U.S.C. §1001 *et seq.* (1995), nonqualified deferred compensation plans must generally be limited to management or highly compensated employees and to independent contractors.

[8] *See* sections 401(a), 414(n), and 7701(a)(20) of the Code as currently in effect.

not plainly at variance with the purposes of that provision. Congress could reasonably have intended the outcome required by the statutory language of section 404, and that language therefore must be enforced.

The Commissioner routinely argues for adherence to the literal language of the Code where tax revenue would be enlarged. *See, e.g., Commissioner v. Soliman*, ___ U.S. ___, 113 S. Ct. 701 (1993); *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992). In her petition for rehearing before the Court of Appeals, the Commissioner estimated that tax revenues of up to $7 billion could be lost in Fiscal Years 1994 through 1999 if Petitioner's position is sustained. App. Pet. at 101a. It is shocking that, if the Commissioner's estimate is correct, she proposes to collect $7 billion in taxes *beyond that authorized by Congress in the language of the Code*.

In sum, the Court of Appeals *admittedly* substituted its own (and dubious) tax policy conclusions for a result required by the language of the Code and supportable under the purposes of the relevant statutory provisions. "Courts are not authorized to rewrite a statute because they might deem its effects susceptible of improvement." *Badaracco v. Commissioner*, 464 U.S. 386, 398 (1984). This issue involves both jurisprudential considerations of broad significance, and substantive tax considerations of meaningful import to taxpayers and the federal fisc. This issue therefore warrants this Court's review.

CONCLUSION

For the foregoing reasons, this Court should grant the petition for writ of certiorari.

Respectfully submitted,

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July 14, 1995